

**GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2011**

**SESSION LAW 2011-390
HOUSE BILL 619**

AN ACT TO SPECIFY THE SECRETARY OF REVENUE'S AUTHORITY TO ADJUST
THE NET INCOME OF A CORPORATION OR TO REQUIRE A CORPORATION TO
FILE A COMBINED RETURN.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-130.6 is repealed.

SECTION 2. Part 1 of Article 4 of Chapter 105 of the General Statutes is amended by adding a new section to read:

"§ 105-130.5A. Secretary's authority to adjust net income or require a combined return.

(a) Notice. – When the Secretary has reason to believe that any corporation so conducts its trade or business in such manner as to fail to accurately report its State net income properly attributable to its business carried on in the State through the use of transactions that lack economic substance or are not at fair market value between members of an affiliated group of entities, the Secretary may, upon written notice to the corporation, require any information reasonably necessary to determine whether the corporation's intercompany transactions have economic substance and are at fair market value and for the accurate computation of the corporation's State net income properly attributable to its business carried on in the State. The corporation must provide the information requested within 90 days of the date of the notice.

(b) Adjust Net Income. – If upon review of the information provided, the Secretary finds as a fact that the corporation's intercompany transactions lack economic substance or are not at fair market value, the Secretary may redetermine the State net income of the corporation properly attributable to its business carried on in the State under this section by (i) adding back, eliminating, or otherwise adjusting intercompany transactions to accurately compute the corporation's State net income properly attributable to its business carried on in the State, or, if such adjustments are not adequate under the circumstances to redetermine State net income, (ii) requiring the corporation to file a return that reflects the net income on a combined basis of all members of its affiliated group that are conducting a unitary business. The Secretary shall consider and be authorized to use any reasonable method proposed by the corporation for redetermining its State net income attributable to its business carried on in the State. In determining whether the corporation's intercompany transactions lack economic substance or are not at fair market value, the Secretary shall consider each taxable year separately.

(c) Combined Return. – If the Secretary finds as a fact that a combined return is required, the Secretary may, upon written notice to the corporation, require the corporation to submit the combined return, and the corporation shall submit the combined return within 90 days of the date of the notice. The submission by the corporation of the combined return required by the Secretary shall not be deemed to be a return or construed as an agreement by the corporation that an assessment based on the combined return is correct or that additional tax is due by the Secretary's deadline for submitting the combined return. The Secretary or the corporation may propose a combination of fewer than all members of the unitary group, and the Secretary shall be authorized to consider whether such proposed combination is a reasonable means of redetermining State net income; provided, however, the Secretary shall not require a



combination of fewer than all members of the unitary group without the consent of the corporation.

(d) Written Statement of Findings. – If the Secretary makes an adjustment or requires a combined return under this section, the Secretary shall provide the corporation with a written statement containing detail of the facts, circumstances, and reasons for which the Secretary has found as a fact that the corporation did not accurately report its State net income properly attributable to its business carried on in the State and the Secretary's proposed method for computation of the corporation's State net income no later than 90 days following the issuance of a proposed assessment as provided in this section.

(e) Members of Affiliated Group. – The Secretary may require a combined return under this section regardless of whether the members of the affiliated group are or are not doing business in this State.

(f) Economic Substance. – A transaction has economic substance if (i) the transaction, or the series of transactions of which the transaction is a part, has one or more reasonable business purposes other than the creation of State income tax benefits and (ii) the transaction, or the series of transactions of which the transaction is a part, has economic effects beyond the creation of State income tax benefits. In determining whether a transaction has economic substance, all of the following apply:

- (1) Reasonable business purposes and economic effects include, but are not limited to, any material benefit from the transaction other than State income tax benefits not allowable under subdivision (3) of this subsection.
- (2) In determining whether to require a combined return, whether the transaction has economic effects beyond the creation of State income tax benefits may be satisfied by demonstrating material business activity of the entities involved in the transaction.
- (3) If State income tax benefits resulting from a transaction, or a series of transactions of which the transaction is a part, are consistent with legislative intent, such State income tax benefits shall be considered in determining whether such transaction has business purpose and economic substance.
- (4) Centralized cash management of an affiliated group as defined in subsection (i) of this section shall not constitute evidence of an absence of economic substance.
- (5) Achieving a financial accounting benefit shall not be taken into account as a reasonable business purpose for entering into a transaction if the origin of such financial accounting benefit is a reduction of State income tax.

(g) Allocation of Income and Deductions. – In determining whether transactions between members of the affiliated group of entities are not at fair market value, the Secretary shall apply the standards contained in the regulations adopted under section 482 of the Code.

(h) Apportionment. – If the Secretary requires a combined return under this section, the combined State net income of the corporation and the members of the affiliated group of entities shall be apportioned to this State by use of an apportionment formula that accurately reports the State net income properly attributable to the corporation's business carried on in the State and which fairly reflects the apportionment formula in G.S. 105-130.4 applicable to the corporation and each member of the affiliated group included in the combined return.

(i) Affiliated Group Defined. – For purposes of this section, an affiliated group is a group of two or more corporations or noncorporate entities in which more than fifty percent (50%) of the voting stock of each member corporation or ownership interest of each member noncorporate entity is directly or indirectly owned or controlled by a common owner or owners, either corporate or noncorporate, or by one or more of the member corporations or noncorporate entities. Nothing in this subsection shall be construed to limit or negate the Secretary's authority to add back, eliminate, or otherwise adjust intercompany transactions

involving the listed entities to accurately compute the corporation's State net income properly attributable to its business carried on in the State, as provided in subsection (b) of this section.

The following entities shall not be included in a combined return:

- (1) A corporation not required to file a federal income tax return.
- (2) An insurance company, other than a captive insurance company, (i) which is subject to tax under Article 8B of this Chapter, (ii) whose premiums are subject to tax under Article 21 of Chapter 58 or a similar tax in another state, (iii) which is licensed as a reinsurance company, (iv) which is a life insurance company as defined in Section 816 of the Code, or (v) which is an insurance company subject to tax imposed by Section 831 of the Code. A "captive insurance company" means an insurer that is part of an affiliated group where the insurer receives more than fifty percent (50%) of its net written premiums or other amounts received as compensation for insurance from members of the affiliated group.
- (3) A corporation exempt from taxation under section 501 of the Code.
- (4) An S corporation.
- (5) A foreign corporation as defined in section 7701 of the Code, other than a domestic branch thereof.
- (6) A partnership, limited liability company, or other entity not taxed as a corporation.
- (7) A corporation with at least eighty percent (80%) of its gross income from all sources in the tax year being active foreign business income as defined in section 861(c)(1)(B) of the Code in effect as of July 1, 2009.

(j) Proposed Assessment or Refund. – If the Secretary redetermines the State net income of the corporation in accordance with this section by adjusting the State net income of the corporation or requiring a combined return, the Secretary shall issue a proposed assessment or refund upon making such redetermination. The procedures for a proposed assessment or a refund in Article 9 of Chapter 105 shall be applicable to proposed assessments and refunds made under this section.

(k) Penalties. – If a combined return required by this section is not timely submitted by a corporation, then the corporation is subject to the penalties provided in G.S. 105-236(a)(3). Penalties shall not be imposed on an assessment under this section except as expressly authorized in this section and in G.S. 105-236(a)(5)f.

(l) Advice. – A corporation may request in writing from the Secretary specific advice regarding whether a redetermination of the corporation's State net income or a combined return would be required under this section under certain facts and circumstances. The Secretary may request information from the taxpayer that is required to provide the specific advice. The Secretary shall provide the specific advice within 120 days of the receipt of the requested information from the taxpayer. G.S. 105-264 governs the effect of this advice.

(m) Extension. – The Secretary and the taxpayer may extend any time limit contained in this section by mutual agreement.

(n) Other Tax Adjustments. – Nothing in this section shall be construed to limit or negate the Secretary's authority to make tax adjustments as otherwise permitted by law, except that the Secretary shall not make adjustments pursuant to this section that limit a corporation's options for reporting royalty payments under G.S. 105-130.7A.

(o) Appeals. – If the corporation appeals a final determination by the Department under this section to the Office of Administrative Hearings in a contested tax case, the administrative law judge shall review de novo (i) whether the separate income tax returns submitted by the taxpayer fail to report State net income properly attributable to its business carried on in this State through the use of intercompany transactions that lack economic substance or are not at fair market value between members of an affiliated group of entities; (ii) whether the

Department's means of determining the corporation's State net income under this section is an appropriate means of determining the corporation's State net income properly attributable to this State; and (iii) if a combined return is required by the Department, whether adjustments other than requiring the corporation to file a return on a combined basis are adequate under the circumstances to redetermine State net income."

SECTION 3. G.S. 105-130.15(a) reads as rewritten:

"(a) The net income of a corporation shall be computed in accordance with the method of accounting it regularly employs in keeping its books. The method must be consistent with respect to both income and deductions. ~~If this method does not clearly reflect the income, the computation shall be made in accordance with a method that, in the Secretary's opinion, does~~ clearly reflect the income, ~~but deductions and~~ shall follow as nearly as practicable the federal practice, unless contrary to the context and intent of this Part.

The Secretary may adopt the rules and regulations and any guidelines administered or established by the Internal Revenue Service unless contrary to any provisions of this Part."

SECTION 4. G.S. 105-130.16 reads as rewritten:

"§ 105-130.16. Returns.

(a) ~~Return.~~—Every corporation doing business in this State must file with the Secretary an income tax return showing specifically the items of gross income and the deductions allowed by this Part and any other facts the Secretary requires to make any computation required by this Part. The return of a corporation must be signed by its president, vice-president, treasurer, or chief financial officer. The officer signing the return must furnish an affirmation verifying the return. The affirmation must be in the form required by the Secretary.

(b) ~~Correction of Distortions.~~—~~When the Secretary has reason to believe that any corporation so conducts its trade or business in such manner as to either directly or indirectly distort its true net income and the net income properly attributable to the State, whether by the arbitrary shifting of income, through price fixing, charges for service, or otherwise, whereby the net income is arbitrarily assigned to one or another unit in a group of taxpayers carrying on business under a substantially common control, the Secretary may require any facts the Secretary considers necessary for the proper computation of the entire net income and the net income properly attributable to the State, and in determining these computations, the Secretary must have regard to the fair profit that would normally arise from the conduct of the trade or business.~~

(c) ~~Other Corrections.~~—~~When any corporation liable to taxation under this Part conducts its business in such a manner as to either directly or indirectly benefit the members or stockholders thereof or any person interested in the business by selling its products or goods or commodities in which it deals at less than the fair price which might be obtained therefor, or when a corporation, a substantial portion of whose capital stock is owned either directly or indirectly by another corporation, acquires and disposes of the products of the corporation so owning a substantial portion of its stock in such a manner as to create a loss or improper net income for either of the corporations, or when a corporation, owning directly or indirectly a substantial portion of the stock of another corporation, acquires and disposes of the products of the corporation of which it so owns a substantial portion of the stock in such manner as to create a loss or improper net income for either of the corporations, the Secretary may determine the amount of taxable income of the such corporations for the calendar or fiscal year, having due regard to the reasonable profits which, but for such arrangement or understanding, might or could have been obtained by the corporations liable to taxation under this Part from dealing in such products, goods or commodities."~~

SECTION 5. G.S. 105-236(a)(5)f. reads as rewritten:

"(a) Penalties. – The following civil penalties and criminal offenses apply:

...

(5) Negligence. –

...

- f. Consolidated or combined return. – The amount of tax shown as due on a consolidated or combined return filed at the request of the Secretary under Part 1 of Article 4 of this Chapter is not considered a deficiency and is not subject to this subdivision unless one or more of the following applies:
1. The return is an amended consolidated or combined return that includes the same corporations as the initial consolidated or combined return filed at the request of the Secretary. In this case the deficiency is the extent to which the amount shown as due on the amended return exceeds the amount shown as due on the initial return.
 2. ~~The Secretary has adopted permanent rules in accordance with G.S. 105-262 that describe the facts and circumstances under which the Secretary will require a consolidated or combined return under G.S. 105-130.6, and the Secretary requires the taxpayer to file a consolidated or combined return under that statute because the taxpayer's facts and circumstances meet those described in the rules.~~
 3. Pursuant to a written request from a taxpayer, the Secretary has provided written advice to that taxpayer stating that the Secretary will require a consolidated or combined return under the facts and circumstances set out in the request, and the Secretary requires a taxpayer to file a consolidated or combined return under ~~G.S. 105-130.6~~ G.S. 105-130.5A because the taxpayer's facts and circumstances meet those described in the written advice."

SECTION 6. G.S. 105-264 is amended by adding a new subsection to read:

"(d) Fee. – The Secretary may charge a fee for providing specific written advice at the request of a taxpayer. The fee is a receipt of the Department and must be applied to the costs of providing the specific advice. The proceeds of the fee must be credited to a special account within the Department and do not revert but remain in the special account until spent by the Department for the costs of providing the specific advice. The Secretary may adopt a tiered fee structure based on the taxpayer's income or gross receipts, the relative complexity of the advice requested, or the tax schedule for which advice is requested. The fee shall not be less than one hundred dollars (\$100.00) or more than five thousand dollars (\$5,000). The fee may be waived by the Secretary."

SECTION 7. The date by which the Department must issue a final determination under G.S. 105-241.14 for any request for review pending as of the effective date of this act under G.S. 105-130.6 is extended until June 30, 2012.

SECTION 7. The Revenue Laws Study Committee may review the law enacted by this act and recommend any changes needed. The Committee may also recommend to the 2012 Regular Session of the 2011 General Assembly the extent to which the law enacted by this act should apply to pending assessments and requests for refunds.

SECTION 8. Sections 1 through 6 of this act become effective January 1, 2012, and Sections 2 and 5 of this act apply to assessments proposed for taxable years beginning on or after that date. The remainder of this act is effective when it becomes law.

In the General Assembly read three times and ratified this the 18th day of June, 2011.

s/ Philip E. Berger
President Pro Tempore of the Senate

s/ Thom Tillis
Speaker of the House of Representatives

s/ Beverly E. Perdue
Governor

Approved 4:17 p.m. this 30th day of June, 2011